

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
HAMMOND DIVISION

IN RE:)
)
MAURICE TYNELL KELLY,) CASE NO. 08-23815 JPK
) Chapter 7
Debtor.)

MEMORANDUM AND DECISION REGARDING CONTESTED
MATTER ARISING FROM DEBTOR'S OBJECTION TO
MOTION FOR TURNOVER BY THE CHAPTER 7 TRUSTEE

On February 25, 2009, Stacia L. Yoon, as the Chapter 7 Trustee of the bankruptcy estate of Maurice Tynell Kelly ("Trustee"), filed a Motion for Turnover. This motion requested turnover to the Trustee of "86% of 2008 State and Federal tax refund in the amount of \$7,541.01". On March 13, 2009, the debtor, by counsel, filed a timely objection to the Trustee's motion. In that objection, the debtor asserted the following in essential response to the Trustee's motion:

5. Debtor contends that the Trustee is only entitled to 50% of said refunds, the reason for this is that he filed his 2008 tax returns jointly with his wife, Glynis Kelly. His wife worked and paid taxes during the relevant tax year, and is entitled to a percentage, half, of the refunds. A copy of the 2008 federal tax return, accountant bill and statement indicating the Indiana tax refund amount, is attached hereto. SEE GROUP EXHIBIT A.
6. Furthermore, debtor contends that said percentage should be reduced by the proportionate fees that he had to pay the tax preparer, HRB Tax Group.

A preliminary pre-trial conference was held with respect to the contested matter arising from the Trustee's motion and the debtor's objection thereto on April 17, 2009, as a result of which the court entered an order dated April 29, 2009 which stated the following with respect to the record before the court for determination of this contested matter:

At the preliminary pre-trial conference, Attorney Mack stated that the debtor's wife had income of approximately \$1,200.00 in calendar year 2008, but that that income was not reported on the

2008 joint tax returns filed by the couple. The factual record is therefore that all refunds received by the debtor and his spouse with respect to 2008 state and federal taxes were derived solely from income tax withheld from the debtor's wages, and that no part of those refunds was generated by the non-debtor spouse's tax payments. This factual record constitutes the entire factual record before the court for determination of this contested matter; no further evidence will be considered.

Pursuant to the foregoing order, the parties filed their respective memoranda of law. To clarify the record, by order entered on July 20, 2009, the court scheduled a hearing for August 21, 2009. The result of that hearing is documented by record entry #41, entered on August 21, 2009, which establishes that the debtor's wife received \$1,200.00 of income in 2008 which was not reported on the joint federal and state income tax returns filed by the debtor and his wife for that tax year; that the debtor and his wife were married on the date of filing of the petition; and that no proceeding of any kind had been initiated or was pending by or on the date of filing of the petition in relation to the marital relationship between the debtor and his wife.

The court has jurisdiction of this contested matter pursuant to 28 U.S.C. § 1334(b), 28 U.S.C. § 157(a) and (b), and N.D.Ind.L.R. 200.1(a). The contested matter is a "core" proceeding under 28 U.S.C. § 157(b)(2)(E).

The issue presented to the court is the extent to which the Trustee's Motion for Turnover filed on February 25, 2009 should be granted. The record before the court is that all refunds received by the debtor Maurice Tynell Kelly with respect to 2008 state and federal taxes, pursuant to joint returns filed by the debtor and his spouse with respect to those taxes, were derived solely from income tax withheld from the wages of Maurice Tynell Kelly, and that no part of those refunds was generated by his spouse's withheld tax payments. In addition, the record establishes that the non-debtor spouse received \$1,200.00 of income in tax year 2008 which was not reported on the joint federal and state income tax returns filed by the debtor and his spouse for tax year 2008.

The debtor's principal contention is that his non-debtor spouse has an interest in the 2008 tax refunds such that the entirety of those tax refunds did not constitute property of his bankruptcy estate under 11 U.S.C. § 541(a). This contention is based upon assertions concerning laws of the State of Indiana in relation to concepts under 11 U.S.C. § 541(a).

Let's first start with the concept of equities regarding the debtor's position. It is undisputed that the debtor's spouse earned income in the year 2008 which the debtor and his spouse did not report to federal or state taxing authorities, income which was required to be reported to those authorities by the law applicable to income tax liabilities for the 2008 tax year. Had that income been reported, the refunds at issue in this case would have been less as a result of increased tax liabilities to taxing authorities derived from the inclusion of unreported income in the tax computations made by the debtor and his non-debtor spouse on their joint 2008 tax returns. Despite having failed to comply with the laws of the United States of America and the laws of the State of Indiana regarding reporting of income subject to taxation, the debtor now comes before the court and requests that the court determine that a portion of refunds derived in part from non-reported taxable income should be apportioned to an active actor in the non-reporting of taxable income. The court will not do so. The court rules that a debtor in the position of Maurice Tynell Kelly cannot contest a Trustee's motion for turnover of tax refunds when it is acknowledged that the underlying returns from which refunds emanated were not accurate as to the taxing authorities issuing the refunds by the omission of reportable income from those returns.

But let's not stop with the foregoing. The record establishes that all refunds requested by the Trustee's motion were derived from taxes withheld from the wages of the debtor solely. The debtor cites cases in the State of Indiana relating to disposition of tax refunds in the context of an action for dissolution of marriage. These cases have nothing to do with the circumstance in this case, in which the parties were not undergoing an action for dissolution of marriage and

thus were not seeking to determine their separate interests in tax refunds that arose between the date of filing of their petition for dissolution of marriage and the date of disposition of that petition in relation to property interests which each held. There is no case in Indiana which discusses or determines in any manner the several interests of a husband and wife in a tax refund derived from a joint tax return filed by those spouses, apart from the inapposite cases relating to disposition of property interests in a dissolution of marriage action. The tax refunds at issue derive solely from income earned by the debtor – pre-petition income which constitutes property of the estate, withheld by taxing authorities pursuant to the provisions of applicable law. The withholding of income tax from pre-petition wages is merely a mechanism for the payment of tax, and does not alter the concept that pre-petition wages not paid to the debtor as of the filing of the petition constitute property of the debtor's estate under 11 U.S.C. § 541(a); see, *In re Marvel*, 372 B.R. 425 (Bankr. N.D.Ind. 2007). Comments of the court in *In re Smith*, 310 B.R. 320, 322-323 (Bankr. N.D. Ohio 2004) are appropriate, as follows:

Although joint federal tax filings are authorized by 26 U.S.C. Section 6013(a) of the Internal Revenue Code, 26 U.S.C. Section 6013(a) does not affect the ownership of property rights in the federal refund check proceeds. A basic purpose of 26 U.S.C. Section 6013(a) is to equalize the tax burden of married couples in common law and community property states. 26 U.S.C. Section 6013(a) does not propose, nor does it imply, that any property rights in the proceeds are altered by a joint federal income tax filing. Similarly, O.R.C. Section 5711.14, which permits the filing of joint Ohio tax returns, does not, by its own terms, alter property rights in any joint refunds, and this Court perceives no ground for so implying.

The court agrees with the determination stated in *In re Carlson*, 394 B.R. 491, 495 (8th Cir. BAP 2008), stated as follows:

Although some bankruptcy courts in other states have looked to their marital statutes for guidance, we agree with the Bankruptcy Court here that such reliance is misplaced in this context, particularly since § 518.003 (which, as stated above, provides for the presumption of equal ownership of marital property) expressly states that its terms apply only in marital dissolution proceedings.

(footnote omitted).

In the context of the debtor's memorandum, the argument that I.C. 26-1-3.1-110(d) provides the non-debtor spouse with an interest in the tax refunds in apposite. That provision has nothing to do with ownership of funds subject to joint payees on a negotiable instrument; rather, the provision has everything to do with endorsements necessary to further negotiability of a negotiable instrument in the case of joint payees, so that the stream of commerce with respect to joint payee negotiable instruments can proceed unimpeded without disputes as to ownership interests of joint payees in the proceeds subject to a negotiable instrument. Citation to the case of *In re Innis*, 331 B.R. 784 (Bankr. C.D.Ill 2005) is equally unavailing, and the court simply does not agree with the conclusions derived by that court. The same is true for the debtor's citation to the case of *In re Barrow*, 306 B.R. 28 (Bankr. W.D.N.Y. 2004). Finally, the "equitable" arguments stated in the last paragraph on page 5 of the Debtor's Brief in Opposition to Trustee's Motion for Turnover fall on deaf ears. Any argument that a tax refund is used to support a family ignores the concepts of applicable law – particularly in a circumstance where the parties receiving the refund failed to disclose earned income to the taxing authorities which would affect the amount of the refund to be received by them¹ – and generates a response of "so what" with respect to concepts of property of a bankruptcy estate under 11 U.S.C. § 541(a).

There is no authority for the debtor's assertion that tax preparation expenses should be deducted from the amount subject to turnover: The debtor chose to use a tax preparer to fulfill his legal obligation to file a tax return, and that expense is not allowable under 11 U.S.C.

¹ The record before the court is that the debtor and his non-filing spouse received advice from a third-party tax preparer to not disclose the income received by Mrs. Kelly in tax year 2008 on their joint tax returns. This advice was obviously premised on the fact that the taxing authorities had no way of cross-checking income reported by third party sources against the amount of income stated in the joint return. It may well be, as a result, that the debtor and his spouse did not commit tax fraud. The debtor and his spouse are admonished to in the future report all income which they receive on their tax returns, regardless of the ill-advised advice of a tax preparer.

§ 503(b)(1)(A).

Based upon the foregoing, the court determines that the Trustee's Motion for Turnover should be granted, and that the debtor's objection to that motion should be overruled.

IT IS ORDERED, ADJUDGED AND DECREED that Maurice Tynell Kelly shall turn over to the Chapter 7 Trustee the amount of \$7,541.00 within sixty (60) days of the date of entry of this order.

Dated at Hammond, Indiana on January 7, 2010.

/s/ J. Philip Klingeberger
J. Philip Klingeberger, Judge
United States Bankruptcy Court

Distribution:
Debtor, Attorney for Debtor
Trustee, US Trustee